

Generally, sales of "canned" computer software are taxable retail sales in Illinois. See 86 Ill. Adm. Code 130.1935. (This is a GIL).

July 24, 2001

Dear Xxxxx:

This letter is in response to your letter dated March 28, 2001. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), which can be found at <http://www.revenue.state.il.us/legalinformation/regs/part1200>, the Department's website.

In your letter, you have stated and made inquiry as follows:

On behalf of our client (referred to hereafter as 'Taxpayer' or 'the Taxpayer'), AAA requests a written ruling regarding the applicability of your state's sales tax to the sale of software, software installation services, consulting services, content, content services, and hosting services as described below.

**FACTS -- SCENARIO 1: CONTENT SOFTWARE AND CONTENT INFORMATION**

Taxpayer, with offices located in several states and headquartered in STATE, licenses content software to customers located throughout the United States. Content software is application software that allows the customer to access a database of information on suppliers and distributors including product descriptions, pricing, and availability of product. Generally, this information is customized by the Taxpayer for each customer and licensed separately as a content database. Typically, the Taxpayer is contracted by the customer to obtain all the necessary information for the content database and may include data that it has gathered in a previous contract with another customer. Separate invoices are issued to the customer for the content software and the content database.

The customer can receive both the software and the content database on disk or as an electronic download (the software and the content are delivered to the customer on separate disks, or as separate electronic downloads). On occasion the database is archived by a host provider, which could be the Taxpayer, and accessed by the customer via the Internet.

The Taxpayer may install the software for the customer. These installation services, referred to as consulting services, are optional and separately invoiced from the information (content) gathering services. The Taxpayer may also provide annual

support/maintenance to the customer for the content software and the content database which includes periodic software updates and telephone support. These updates may be provided to the customer either electronically or via disk. The annual support/maintenance agreement is optional and separately invoiced from charges for the software. However, the charge for the annual support/maintenance agreement is not separately stated between the software updates and the telephone support.

While the content information is provided pursuant to the customer's request and customized for the customer's specific needs, the Taxpayer has the option of selling the same information to other customers. The Taxpayer retains all rights in and ownership of the software and the content database.

#### QUESTIONS:

1. Is the **content software** that allows the customer to access the content database subject to sales tax if:
  - delivered to your state by disk?
  - delivered to your state electronically?
  - supplied to a host provider outside your state and accessed by the customer in your state via the Internet?
  - supplied to a host provider within your state and accessed by the customer in your state via the Internet?
  - supplied to a host provider within your state and accessed by the customer in another state via the Internet (assume the customer has no nexus in your state)?
  
2. Is the **content database** subject to sales tax if:
  - delivered to the customer in your state by disk?
  - delivered to your state electronically?
  - supplied to a host provider located outside your state and accessed by the customer in your state via the Internet?
  - supplied to a host provider within your state and accessed by the customer in your state via the Internet?
  - supplied to a host provider within your state and accessed by the customer in another state via the Internet (assume the customer has no nexus in your state)?
  
3. Is the charges for the **optional annual support/maintenance agreement** related to either the content software or the content database subject to sales tax if:
  - delivered to your state by disk?
  - delivered to your state electronically?
  - supplied to a host provider outside your state and accessed by the customer in your state via the Internet?
  - supplied to a host provider within your state and accessed by the customer in your state via the Internet?

- supplied to a host provider within your state and accessed by the customer in another state via the Internet (assume the customer has no nexus in your state)?
4. Is the **optional consulting** charge (i.e., the installation charge) related to either the content software or the content database subject to sales tax if:
- the service is performed at the customer's location in your state and the benefit to the customer is received in your state?
  - the service is performed outside your state, but the benefit to the customer is received in your state?

If your state taxes these charges based on where the benefit is received, how is the benefit location determined? How should the Taxpayer handle the sales tax in your state if the customer's benefit location cannot be determined? Can the Taxpayer accept an exemption certificate from the customer for the full amount of the sale and let the customer determine its locations of benefit and accrue use tax accordingly?

5. If the content database is sold to a second customer with or without modification, would the content then be subject to sales tax in a different manner than the first customer if it is:
- delivered to your state by disk?
  - delivered to your state electronically?
  - supplied to a host provider outside your state and accessed by the customer in your state via the Internet?
  - supplied to a host provider within your state and accessed by the customer in your state via the Internet?
  - supplied to a host provider within your state and accessed by the customer in another state via the Internet (assume the customer has no nexus in your state)?

## **FACTS -- SCENARIO 2: SOFTWARE HOSTING**

Taxpayer, with offices in several states and headquartered in STATE, licenses application software to customers located throughout the United States. This software does not involve the separate content database as described in Scenario I. Typically, the Taxpayer will perform a detailed analysis of the customer's needs, which may require adaptation or modifications to fit the customer's specific environment. During this process, the source code of the software is not changed. The software is shipped to a third party hosting company that will be paying commission to the Taxpayer. It is also possible for the customer to request the Taxpayer to host the software. There are several options to the method of delivery. The software can be placed on a disk and shipped by common carrier to the host provider, transferred electronically to the host provider, or the host provider may already have the software product and transfer the software electronically to a server dedicated to the customer. On occasion the customer has no other presence in your state other than the software license hosted by the third party provider or by the Taxpayer.

QUESTIONS:

6. Is the software subject to sales tax when it is shipped via disk by common carrier to a third party host located within your state when the customer has no other presence in your state other than the licensed software? Does it change the taxability if the customer or the Taxpayer contracts directly with the hosting company? Does it change the taxability if the hosting company is the Taxpayer who sold the software?
7. Is the software subject to sales tax when it is shipped **electronically** to the hosting company when the customer has no other presence in your state other than the licensed software? Does it change the taxability if the customer or the Taxpayer contracts directly with the hosting company? Does it change the taxability if the hosting company is the Taxpayer who sold the software?
8. Is the software subject to sales tax if it is already located at the host provider location and transferred electronically to a server dedicated to the customer when the customer has no other presence in your state other than the licensed software? Does it change the taxability if the customer or the Taxpayer contracts directly with the hosting company? Does it change the taxability if the hosting company is the Taxpayer who sold the software?
9. Is the software subject to sales tax when it is shipped to a hosting location outside your state, but the customer accesses the software from its offices or other facilities located in your state and the state where it is hosted taxes the software? Does it change the taxability if the state where the software is hosted doesn't tax the software?
10. Would the hosting fees for the software be subject to sales tax? If so, would the hosting be taxed differently if the hosting was performed during implementation of the software and before the customer has access to it versus being performed once the software is in production and the customer has full use and access to it?

### **FACTS -- SCENARIO 3: TRANSACTION AND SUBSCRIPTION FEES**

Taxpayer, with offices in several states and headquartered in STATE, licenses application software to customers located throughout the United States. This software could be either the content software with the separate content database as described in Scenario 1 or the Taxpayer's other suite of software discussed in Scenario 2. Typically, the Taxpayer would perform a detailed analysis of the customer's needs, which may require adaptation or modifications to fit the customer's specific environment, but the source code would not be changed. The use of the software can be obtained in several ways. The customer could obtain the software by purchasing a perpetual license or by purchasing a term license, or the customer could be charged fees based on the volume of transactions while using the software, charged fees based on the dollar amounts of the transactions while using the software, or the customer could subscribe to the use of the software without taking possession or having control.

QUESTIONS:

11. If the software license is provided to a customer at no initial cost, but instead for future fees based on a per transaction charge or a percentage of the transaction dollar amount, would these fees be subject to sales tax?
12. If the software is never sold or licensed to the customer, but instead is hosted at the Taxpayer location or by a third party **contracted by the Taxpayer** and the customer is allowed to access the software via the Internet for fees based on the number of transactions or as a percentage of the dollar value of the transactions, would these transaction fees be subject to sales tax?
13. If the software is never sold or licensed to the customer, but the third party hosting company is **hired by the customer** and the customer is allowed to access the software via the Internet for fees based on the number of transactions or as a percentage of the dollar value of the transactions, would these transaction fees be subject to sales tax?
14. If the customer buys a perpetual license, would the software be subject to sales tax? Would any optional consulting fees be subject to sales tax? Would any optional maintenance fees that include both telephone support and updates be subject to sales tax? Would separately stated expenses for travel and meals be subject to sales tax?
15. If the customer buys a **term license**, would the software be subject to sales tax? Would any optional consulting fees be subject to sales tax? Would any optional maintenance fees that include both telephone support and updates be subject to sales tax? Would separately invoiced expenses for travel and meals be subject to sales tax?

#### **FACTS -- SCENARIO 4: CONTRIBUTION OF SOFTWARE**

The Taxpayer on occasion may contribute the software license to another company in exchange for equity in the company.

16. If the software is contributed to a company solely in exchange for stockholder's equity in the company and the Taxpayer receives fees based on the volume of transactions or as a percentage of the dollar value of the transactions, would these fees be subject to sales tax? Would the initial contribution of the software constitute a taxable sale?
17. If the software is contributed to a company for stockholders equity in the company and the Taxpayer receives no compensation other than the equity, would this constitute a taxable sale? Would any optional installation/consulting fees or periodic update fees be subject to sales tax if invoiced separately? Would reimbursed expenses that are billed to the customer be subject to sales tax?

#### **Ruling Request**

We respectfully request a written ruling concerning the proper application of your state's sales tax to the above scenarios. Please address each question individually and provide supporting citations for your determinations. A Glossary of Terms is attached for your convenience.

We appreciate your assistance with this request. Should you have any questions, please contact me.

The Retailers' Occupation Tax Act imposes a tax upon persons engaged in the business of selling at retail tangible personal property. 35 ILCS 120/2 (1998 State Bar Edition). The Use Tax Act imposes a tax upon the privilege of using in this State tangible personal property purchased at retail from a retailer. 35 ILCS 105/3 (1998 State Bar Edition).

Generally, sales of 'canned' computer software are taxable retail sales in Illinois regardless of whether the software is transferred by disk or electronically. See 86 Ill. Adm. Code 130.1935. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See Section 130.1935(c).

Custom computer programs or software are prepared to the special order of the customer. The selection of pre-written or canned programs assembled by vendors into software packages does not constitute custom software unless real and substantial changes are made to the programs or creation of program interfacing logic. See Section 130.1935(c)(3).

If transactions for the licensing of computer software meet all of the criteria provided in Section 130.1935(a)(1), neither the transfer of the software or the subsequent software updates will be subject to Retailers' Occupation Tax. A license of software is not a taxable retail sale if:

- A) It is evidenced by a written agreement signed by the licensor and the customer;
- B) It restricts the customer's duplication and use of the software;
- C) It prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party) without the permission and continued control of the licensor;
- D) The licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or permitting the licensee to make and keep an archival copy, and such policy is either stated in the license agreement, supported by the licensor's books and records, or supported by a notarized statement made under penalties of perjury by the licensor; and
- E) The customer must destroy or return all copies of the software to the licensor at the end of the license period. This provision is deemed to be met, in the case of a perpetual license, without being set forth in the license agreement.

In the context of a General Information Letter, the Department cannot give you a binding ruling as to whether the agreement you attached to your letter meets the requirements of Section 130.1935. If all of the above criteria were met, then neither the transfer of the software or the subsequent software updates will be subject to Retailers' Occupation Tax.

We note that you provide access to databases. Please note that the Telecommunications Excise Tax is imposed upon the act or privilege of originating or receiving intrastate or interstate telecommunications in Illinois at the rate of 7% of the gross charges for such telecommunications purchased at retail from retailers. See 86 Ill. Adm. Code 495, enclosed.

As you can see from 86 Ill. Adm. Code 495.100(c), charges for automated information retrieval or data processing are not taxable. The regulation contemplates that charges for access to an on-line computer database fall within this category. As the regulation indicates, charges for the inquiry or access are generally not taxable, but charges, if any, for transmission of the data are generally taxable. If retailers provide both transmission and data processing services, the charges for each must be separately disaggregated and identified in the books and records of the retailers. If such charges are not disaggregated in this manner, then all charges are taxable.

Please note that information that is downloaded is generally not taxable because it is intangible. However, if you transfer such information in a tangible format, such as on tape or disk, such transfer is taxable as either a Retailers' Occupation Tax or a Service Occupation Tax transaction depending on whether the item is customized. When you sell an item standard enough to be stocked for sale to the public generally, i.e., one that is not customized to the specifications of a particular purchaser, the entire charge for the product is subject to Retailers' Occupation Tax. If the item, however, were customized for a particular purchaser, it would be subject to the Service Occupation Tax. See discussion below and the enclosed copy of 86 Ill. Adm. Code 140.101 which explains the application of the Service Occupation Tax.

In general, maintenance agreements that cover computer software and hardware are treated the same as maintenance agreements for other types of tangible personal property. The taxability of maintenance agreements is dependent upon whether the charge for the agreement is included in the selling price of tangible personal property. If the charge for a maintenance agreement is included in the selling price of tangible personal property, that charge is part of the gross receipts of the retail transaction and is subject to Retailers' Occupation Tax liability. No tax is incurred on the maintenance services or parts when the repair or servicing is completed.

If maintenance agreements are sold separately from tangible personal property, the sale of the agreement is not a taxable transaction. However, when maintenance services or parts are provided under the maintenance agreement, the company providing the maintenance or repair will be acting as a service provider under the Service Occupation Tax Act. The Service Occupation Tax Act provides that when a service provider enters into an agreement to provide maintenance services for a particular piece of equipment for a stated period of time at a predetermined fee, the service provider incurs Use Tax based upon its cost price of tangible personal property transferred to the customer incident to the completion of the maintenance service. See 86 Ill. Adm. Code 140.301(b)(3), enclosed.

Charges for updates of canned software are fully taxable pursuant to Section 130.1935. If the updates qualify as custom software under Section 130.1935(c), they are not taxable. But, if maintenance agreements provide for updates of canned software, and the charges for those updates are not separately stated and taxed, then the whole agreement would be taxable as sales of canned software.

Assuming that the services provided, such as installation, phone support, training, and seminars, do not require the transfer of tangible personal property to the recipients of those services, charges for such services are exempt if they are separately stated from the selling price of canned software. See Section 130.1935(b). If computer software training or other support services are provided in conjunction with a sale of custom computer software or a license of computer software, the charges for that training are not subject to tax.

The Retailers' Occupation Tax and Use Tax do not apply to receipts from sales of personal

services. Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. For your general information we are enclosing a copy of 86 Ill. Adm. Code 140.101 regarding sales of service and Service Occupation Tax.

The purchase of tangible personal property that is transferred to service customers may result in either Service Occupation Tax liability or Use Tax liability for the servicemen, depending upon which tax base the servicemen choose to calculate their liability. Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on cost price if they are registered de minimis servicemen; or, (4) Use Tax on cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

If a service is provided in which no tangible personal property is transferred, then tax is not incurred.

Section 1 of the Retailers' Occupation Tax Act defines a sale at retail as "any transfer of the ownership of or title to tangible personal property to a purchaser, for the purpose of use or consumption, and not for the purpose of resale in any form as tangible personal property . . . for a valuable consideration. The transfer of software for stock equity is the transfer of tangible personal property for valuable consideration and is therefore subject to tax.

We do not have enough information to make a determination regarding the hosting services you provide. Such a determination is fact specific and can depend upon many factors such as whether any software is transferred.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at [www.revenue.state.il.us](http://www.revenue.state.il.us). If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b).

Very truly yours,

Melanie A. Jarvis  
Associate Counsel

MAJ:msk  
Enc.